The internationalization of franchising systems into industrialized economies

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Abstract:

Franchising began in the United States in the 1850s with the Singer Sewing Machine Company. One of the most famous beginning franchisors was Henry Ford, who figured out that the value of franchise systems was to distribute cars quickly to yearning first-time car buyers, while not being encumbered with the cost of inventory. Today, franchising encompasses a system that is used around the world to sell over 1 trillion dollars' worth of goods and services from Tokyo to New York (Reynolds, 2002). Franchising is powerful. Franchising is here to stay. This chapter summarizes the preeminent research in the field of international franchising, concentrating on North America, the Pacific Rim and other industrialized countries. These countries can be considered to have the most advanced forms of franchising with the most market penetration. It is worth noting that North America is the home of the most franchisors' headquarters. The two other countries that are experiencing phenomenal growth in franchising that we will cover in this chapter are Israel and South Africa.

Keywords: franchising | internationalization | entrepreneurship | international franchise

Chapter:

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North America

Dianne Welsh (2002) looks at franchising from a futuristic perspective, examining where franchising has been in the 1970s, 1980s and 1990s in the United States and Canada and where it is headed. Currently, franchising is 40 percent of retail trade in the USA and 25 percent in Canada (Fenwick, 2001; Scrivener, 2001). In her article, Welsh covers the definitions of franchising, regulations, survival rates, recent developments and future trends. One trend identified is the focus on self-reliance. Young people want higher income, job security and self-satisfaction that come with owning their own business or franchise. This will affect franchising growth positively, especially for women and minorities internationally. Additionally, she defines the term, 'transgenerational franchising' (Welsh, 2002).

John Clarkin (2002) examines the differences in expansion strategies among more than 1200 North American franchises. International market development is continuing to be increasingly important. Tue study examines two major issues: the differences in size, age and other characteristics between those pursuing international expansion and those not, and the possible motivations for international expansion. Clarkin's study (2002) found similar results to a study done 27 years earlier that found opportunity recognition to be a more important motivator for international expansion than market saturation. He explains the reasons for the findings and their implications.

Multi-unit and master franchising

Marko Grunbagen and Robert Mittelstaedt (2002), one of the founders of the International Society of Franchising, give us a historical synopsis of franchising, and then look at the state of the franchise industry and recent developments that have spurred its growth and expansion. They describe new industry segments that have emerged, including franchisees' minichains that cross states and regions. They also discuss the reasons behind the astronomical growth of multi-unit franchising from the franchisor as well as the franchisee perspectives. The major advantages usually cited to franchise are covered, with the authors giving some new reasons not previously considered.

Grunhagen and Mittelstaedt also look at the motivations of multi-unit franchisees, which may be different from the usual explanations given for franchising. The literature gives three reasons why individuals franchise: single unit franchisees are so eager to get into business for themselves that they become risk-indifferent; multi-unit operators believe they can 'beat the system' by the advantages of a larger and more geographically dispersed locations; and franchisees are not entrepreneurs so they need the system franchising has built in. The authors argue that entrepreneurship is an important motivator for multi-unit franchisee ownership. The article adds to the body of literature by addressing franchisee motivations and concluding that entrepreneurship is a reasonable explanation for the growth of multi-unit franchising.

In his article, 'The organisational determinants of master international franchising', Ilan Alon (2000) first defines and explains why master franchising is such a popular form for global expansion. He then goes on to develop a group of propositions concerning the impact of certain organizational variables on the use of master franchise agreements overseas. These types of agreements are primarily used for business format franchisors. He divides the factors into three explanations: resource-based, knowledge-based and strategy-based. The resource-based explanation looks at size, age and brand name asset specificity. The knowledge-based explanations include know-how and experience in managing global operations. Price, product and strategies are given as strategy-based reasons. These explanations should be examined before a franchisor enters a host country and decides the level of risk that he or she is able to tolerate. Alon gives a theoretical framework for global expansion that can be added to and is sorely needed in the field.

Somchanok Coompanthu and Kendall Roth's (2002) article focuses on international services and explores the various organizational forms that are possible and their impact on profitability. In particular, the article focuses on the use of plural management. Plural management can be defined as using a combination of company-owned or company-operated and franchised forms. Unit growth, uniformity, local responsiveness and system-wide adaptation are all affected by the use of plural management. It was found that, when there is high performance ambiguity or when it is difficult to determine employee job performance, firms are more likely to use franchised forms for international expansion. When there is a great deal of outcome uncertainty, company-owned and company-operated forms are more likely. The authors urge franchisors to look at the nature of the industry and the organizational forms that have worked best to achieve a higher performance level in the future. Plural management is offered as a strategic solution to the problems of achieving tight control if there is high performance ambiguity and the need to respond effectively to local markets.

Erramilli *et al.* (2002) also look at global entry modes in the service industry. However, their article focuses on non-equity modes of entry that feature minimal or no investment requirements. In particular, these nonequity modes are popular among consumer services firms, such as hotels and restaurants. Professional services firms, for example consulting businesses, rarely use this form. The study looks at the reasons for choosing between two non-equity modes: franchising and management service contracts. It takes the perspective that the form that most effectively transfers organizational capabilities is the form that should be adopted, rather than the one that provides the most effective control over the subsidiary. The latter is the form most recommended by international business theories. An international sample of hotel firms was used to find that capabilities that are difficult to imitate cannot be effectively transferred through franchising. In such cases, a management service contract was preferable. Infrastructure was found to be critical to the type of mode chosen and the success of the franchise. Additionally, the level of development of the country had an effect. In countries where customers are more service-conscious, and there is an ample supply of talented managers and investors, franchising works better. The authors warn that the firms focus mostly on the transfer characteristics of their business when making these modal decisions. If they are not perfectly imitable, there will be problems with franchising and more frequent calling for management service contracts.

Global franchise relationships

Jorg Sydow (2002) examines the service sector also, but looks at network leadership. He argues that, strategically, franchise systems need to link to interorganizational networks and be more relationship oriented. He also covers the management practices that are necessary for this to happen and anchors his recommendations in the theories that have been developed on structure. He illustrates the application of this theory with six business format franchise networks in Germany: McDonald's ® (fast food restaurants), OBI (retail superstores), Aufina (real estate agencies), Schulerhilfe (tutoring providers), ComputerLand (retail sales and computer services) and Hyper Services (service providers). Sydow offers concrete suggestions for the industry to follow as well as implications for management that have global applications.

Charles Keith Hawkes and Soumava Bandyopadhyay (2002) build a framework that examines the cultural and legal barriers that American franchisors could face as they expand globally. Their framework is built on two dimensions: the cultural distance (more versus less) of the market from the United States, and the extent of legal barriers (few versus many) in the market compared to the United States. Strategies that should be taken by the franchisor in view of these barriers are explicated. For example, *if* the countries are culturally close to the US but have more legal barriers, such as Italy and Spain, product or trade name franchising may be a better operating choice than business format franchising. In countries that are culturally distant from the US but have relatively fewer legal barriers, such as Japan, the opposite should be true. In the Gulf Region (Middle East), a great deal of adaptation of the product and the business format would be necessary because many legal barriers exist in these countries and they are culturally distant. In all, this article offers practical advice that is easily understood and implemented.

The United States

Fred DeLuca created the second largest franchise operation in the world when he created Subway. In North America, Subway just surpassed McDonald's with the greatest number of locations. Fred tells his story of how Subway conquered America and then spread worldwide. It all began in 1965 with the help of a family friend who loaned him $1000 to help pay for college tuition. In 2002, the business had more than 16000 franchised restaurants in 74 countries. The DeLuca *et al.* article covers the management challenges facing the franchise as it has expanded globally as well as a summary of its growth in certain counties, including Australia, Venezuela, India, and China. The article concludes with a summary of future endeavors on the horizon.

Ilan Alon (2002) analyzes how these industries have expanded globally through the number of outlets, including size and scale, the growth rate, the pricing strategy and the geographical dispersion. These factors aid in explaining why franchisors have gone global. However, there are differences between the three industries that are discussed. For instance, the age of the franchise was an insignificant factor for the hotel and professional business service categories, and had a negative relationship to internationalization in the retailing sector. One of the most interesting findings of the study involved the fact that younger franchisors in the retail sector were more likely to franchise. Alon provides clear evidence that the decision to go international should be studied at the industry level. This study clears the way for the development of a complete model of internationalization that is sorely needed by the franchise industry to make better decisions on where, when and why to go global.

Canada

With a population of 30 million and its close proximity and culture, Canada is often the first stop for US franchisors to expand internationally. Paul Jones and Michelle Wong (2002) describe the current state of the Canadian market, including currency, banking, legislation at the federal and province levels, and regulations. Additionally, the authors discuss the numerous factors to consider in adapting franchise agreements to the Canadian market, in particular the enforcement of contracts from one province to the next. Two provinces which have their own franchise legislation (Alberta and Ontario) are covered in detail in the article. Canada has followed the lead of the European Union and enacted the Personal Information Protection and Electronic Documents Act which protects all personal information in the private sector collected in the course of commercial activities by companies. Quebec has bad such legislation in place since 1994, while Ontario has prepared a draft of its own privacy legislation and two other provinces are in the process of doing the same. In 2004, the federal legislation will extend to the provinces that have not passed their own legislation concerning privacy. In all, Jones and Wong's article comprehensively covers all basic aspects of what a franchisor needs to know to enter the market. It would benefit potential and existing franchisees to read the article in order to gain complete understanding of the entire franchise system in Canada.

The Pacific Rim

This vast area of the world *is* an open door to franchisors looking for densely populated consumer markets that are receptive to new opportunities. Despite the critics' misgivings, western fast food chains first entered East Asian markets with a great deal of success. Kentucky Fried Chicken (KFC) average sales per store in Asia are US $1.2 million per year, compared to per store revenues in the United States of $750000 per year. Stephen Choo (2002) chose three franchisors with different capabilities and levels of internationalization to illustrate the critical success factors needed to enter the East Asian market. Dome Coffees from Australia, The Coffee Bean & Tea Leaf Company from the United States and Royal Copenhagen Ice Cream from Australia are qualitatively analyzed using the techniques of Yin (1994) and Miles and Huberman (1994). Results showed that there were six main key success factors in the East Asian market: distance management, contract enforcement, cultural adaptability, host country risk management, marketing approach and partnership management. The greater the cultural differences between the franchisor and franchisees in East Asia, the more important these success factors become in transferring a profitable franchise system. Choo makes a significant contribution in providing any potential or current franchisor with a useful insight into approaching and competing successfully in this market.

Japan

Nitin Sanghavi (2002) reviews the opportunities and challenges for companies to use franchising as a growth strategy in the Japanese market. He covers the recent developments in the Japanese and retail consumer markets, the effect of the stock market and what it will take to be profitable in this densely populated country. Compared to other industries, franchising has done relatively well, maintaining a growth rate of 6 to 8 percent. In terms of number of stores, service-related franchises showed the most growth, although sales per store were not as significant as food services or retail commerce franchises. Some 70 percent of the total increase in sales of the franchise industry as a whole was in retail commerce franchises. The author helps the reader to understand the effect of various business customs and lifestyle trends on franchise success in Japan and explains how the franchise should include these factors in its overall business strategy and structure to be successful.

New Zealand

Franchising in New Zealand bas grown exponentially in the past five years. John Paynter (2002) summarizes the history of franchising and the results of the annual survey of the Franchise Association of New Zealand since its inception. A total of 111 systems is analyzed in terms of the number currently operating in the country, the number of people employed, the number of franchised and company-owned units, the percentage increase in sales growth, the industry groupings by percentage, the number of native franchise operations and the median start-up costs, among other statistics. Of particular interest are his results on the number of systems that have websites (84 percent) and the failure rate data. Over a three-year period, only 6 percent failed and a miniscule 16 percent of franchisors (6 percent of franchisees) considered franchising not to be a good return on their investment. A hardy 77 percent rated their system excellent or above average. These results are good news for the industry.

Léo Paul Dana (2002a) encapsulates the New Zealand franchise market, which has the highest number of franchises per capita. Additionally, three-quarters of these involve New Zealand-based franchisors. Foreign franchisors are primarily from Australia. Dana gives us a detailed description of both, as well as possible legislation that may be enacted in the future. New Zealand currently does not have any franchise legislation but may enact similar legislation in the future to that passed in July 1998 in Australia.

He also discusses initiatives that the government should consider to aid in franchise development as well as future challenges to the industry. In particular, Dana indicates that future research should explore why New Zealand franchisors tend not to expand globally.

Other countries

Israel

Dana (2002b) analyzes the current state of franchising in Israel, explains why franchising has gained popularity quickly and explores the reasons for its accelerated growth. He gives two basic reasons for this phenomenon. First, Israel is a country composed of many immigrants. In the 1990s, there were a million new immigrants. Secondly, thousands of defense military personnel retired in their early forties with a lump sum payment from the government of $250000 and were looking for investment opportunities. Many bought franchises. That has fueled the growth of home-grown franchises in banking, financial services, fashion and fast food. Interestingly enough, Israeli franchisors have not ventured abroad to a great extent, with a couple of notable exceptions. Burger Ranch has done well, entering the Hungarian and Romanian markets, while Reliable Rent a Car has done well in expanding into the Mediterranean region: Cyprus, Egypt, Italy, Malta, Portugal, Spain and Turkey. Dana also summarizes the legal environment in Israel and what he sees as possible franchise legislation and protection in the future.

South Africa

Anita du Toit's (2002) study of franchising in South Africa focuses on the issue of encroachment in multi-brand franchises with the use of in-depth interviews of franchisors who bad operated a business format franchise and had two or more franchised brands. About 10 percent of the franchisors in South Africa met the criteria. Qualitative analysis with the use of themes to give a larger, consolidated picture was utilized following the suggestions of Creswell (1994). Eight themes emerged and are described in detail in the article: brand management systems, achieving economies of scale, brand positioning, cultural divergence, conflict between stakeholders, policies on geographical proximity, failure of acquisitions and separation of brands. Du Toit concludes by making recommendations for future research based on her results and theorizes that perhaps multi-brand franchises may not be able to be managed successfully to avoid encroachment. She also includes some great recommendations that, if incorporated, would improve brand management of multi-brand franchises and assist in avoiding encroachment problems, good suggestions wherever the franchise is located worldwide.

Conclusions

The advent of franchising is a worldwide phenomenon. The importance of franchising cannot be overlooked. In countries around the globe, franchising affects the economy substantially, with its percentage of the retail trade increasing daily. It accounts for $1 trillion in retail spending per year and employs one in 16 workers in the United States (Reynolds, 2002). In some countries, franchising is approaching half their total retail sales. Although franchising has its critics, and there are franchises to definitely avoid, it is here to stay. The more we know about franchising, the better off the public and the industry will be. We have attempted to answer the call for additional research to understand international franchising by starting where it began, in North America, then covering its growth and development in the industrialized countries of the world. In 2001, we edited two companion volumes that were also published by Commerce Clearing House, now CCH. Inc., *International franchising in emerging markets: Central and Eastern Europe and Latin America* (Welsh and Alon, 200 l) and *International franchising in emerging markets: China, India, and other Asian countries* (Alon and Welsh, 2001). Another volume was published in 2002, *International franchising in industrialized markets: North America, the Pacific Rim, and other countries* (Welsh and Alon, 2002). The fourth volume was *International franchising in industrialized markets: Western and Northern Europe* (Alon and Welsh, 2003). To our knowledge, this is the first attempt to summarize the research on a global basis, from a practitioner as well as an academic viewpoint. Franchisors, franchisees, those studying franchising, the governments of countries interested in furthering economic development and employment, and the massive populations who desire the opportunity to try franchising themselves through purchasing a franchising, starting their own franchise or tasting its fare, all need this information. This chapter offers final reflections as to the state of research in the field and what future research needs to take place. We hope to increase the knowledge level of franchising worldwide and spur increased exploration and research in the field.

In the last chapter of our first book, *International franchising in emerging markets: Central and Eastern Europe and Latin America* (Welsh and Alon, 2001), we identified areas ripe for future research. Forms of franchising and the ability to adapt to the ever-changing global marketplace were mentioned as two areas that needed exploration. We answered the call in our second volume. Four of the articles in this volume discuss various forms of franchising, including multi-unit franchising, master franchising, form choice and plural management, and non-equity modes of entry. In our third volume two of the articles look at adaptation. Jorg Sydow (Welsh and Alon, 2002) discusses network leadership and Charles Keith Hawkes and Soumava Bandyopadhyay (Welsh and Alon, 2002) discuss culture and legal barriers from an international entry perspective.

These papers all point to the same fact: it is becoming more complex for franchising to adapt to a world marketplace that is increasingly accessible with technological advances. There are more forms of franchising, and there is an increasing symbiotic relationship among the various stakeholders of franchising: franchisors, franchisees, host markets and consumers. What has not been addressed is the addition of franchisee associations in these symbiotic relationships and the fact that they are becoming at least as powerful, if not more powerful in some spheres, as associations worldwide that have been traditionally composed of franchisors. We predict that these influential organizations will continue to wield an increasing share of power in the future. Furthermore, it is likely that such franchisor and franchisee organizations, respectively, will join in associations of their counterparts by region or to mirror political associations, such as the European Franchise Federation (EFF) has formed as the European Union (EU) has become a reality. In larger part, these organizations will eventually exert a major influence on supplier networks, legislation, regulatory standards and safeguards, and shared technology and communication. They will transcend language and cultural barriers to create networks that are user-friendly. As John Reynolds, President of the International Franchising Foundation mentions in his foreword, John Naisbitt, author of *Megatrends* (1982), predicted that the future of franchising would benefit from an increasingly service-based economy, an increasingly convenience-oriented society, a more specialized workforce, more participation by women and minorities, and an increasingly globally based marketing strategy. The articles in these volumes reveal that his future trend analysis is coming true sooner than originally predicted. Research will make us understand where these trends are and where the industry is going.

Family business franchises are now entering their second generation, and a small number are even third-generation franchises. This is particularly true of franchises in the United States, as it has the longest history of franchising. However, other parts of the world that particular franchises first developed, such as hotel and restaurant industries, are also experiencing 'transgenerational franchising'. Transgenerational franchising, as defined by Dianne Welsh, is the continuing operation of a franchise or franchises that have gone from the original franchisee(s) to another generation of franchisee(s) that are connected either by family membership or ownership. When the international component is added to a transgenerational franchise or network of franchises, a more complex form of franchising emerges. This has major implications for the franchisor who is trying to maintain positive relationships with franchisees. Additionally, the franchisor may be transgenerational. Welsh calls this the 'blind date' phenomenon in franchising. The ability of the franchise system to sustain these long-term relationships could have a major impact on the future of franchising.

The Raymond Institute is in the process of conducting a survey on US family businesses and is requesting that family business franchises take part (Markins, 2002). Dianne Welsh is working with the Raymond Institute to understand the impact of family businesses on franchising and the actual size of this population that is predicted to keep growing in the future. Since franchising accounts for 5 percent of the 8 million small businesses in the USA, and two-thirds of these small businesses are considered family businesses, the impact of this combination is profound in real terms today. In some parts of the globe, such as the Pacific Rim, the percentage of family businesses is even higher, up to 90 percent or more. Tomorrow, the way we do business from a management, marketing and legal standpoint may be very different as a consequence of these changing demographics. This area is ripe for research and methodologically should be studied using longitudinal data analyses.

Internationalization of the franchise systems in developed countries has increased the importance of organizational management and learning issues in the global context. That is why Cecilia Falbe and Dianne Welsh composed panels on leadership, vision, strategic decision making and the Internet at the 2001 International Society of Franchising Conference (Welsh, Adler, Falbe, Gardner and Rennick, 2001). Ilan Alon and Dianne Welsh also organized a panel on international franchising in emerging markets to address such issues as they relate to global franchising (Alon and Welsh, 2002) that featured leading experts on global franchising such as Marcel Portman, Rajiv Dant, Skip Swerdlow, John Stanworth, Audesh Paswan and Cecilia Falbe. If the industry is to continue to grow, it needs to transform itself into a 21st-century learning organization. Technology can be compared to a moving treadmill, with the speed of information continually moving up to the next level. Communication is of utmost importance in this age. The environment must be continually scanned for relevant information on the market and its customers. The franchisor and the headquarters staff must provide leadership to communicate their vision to the franchise community. In turn, the franchisees, customers and associations must communicate their vision of the future to the franchisor. Strategic decision making must evolve from this interaction. It is important that the vision is clear to all stakeholders. The world marketplace demands it.

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